From: "Duke, Robert" <rduke@surety.org>
To: <secretary@fmc.gov>
Date: Fri, May 30, 2003 1:41 PM
Subject: Passenger Vessel Financial Responsibility NPRM Docket No. 02-15

Enclosed herewith are the comments of The Surety Association of America regarding Notice of Proposed Rulemaking, Docket No. 02-15. Please contact me if you have any questions.

Robert Duke
The Surety Association of America

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May 30, 2003

Mr. Bryant L. VanBrakle
Secretary
Federal Maritime Commission
800 North Capitol Street, NW, Room 1046
Washington, DC 20573

Re: Notice of Proposed Rulemaking
Docket No. 02-15
Passenger Vessel Financial Responsibility

Dear Mr. VanBrakle:

The Surety Association of America is a trade association of approximately 590 insurance companies that write the majority of surety bonds in the United States. In this letter, we provide comments regarding the referenced proposed rule which would amend the regulations regarding the establishment of financial responsibility for passenger vessel operators ("PVOs") set forth in 46 C.F.R. Part 540. The proposed rule contains two revisions which likely would impact negatively the availability of surety bonds. First the proposed rule eliminates the $15 million ceiling for the required financial assurance, which currently is set forth in 46 C.F.R. § 540.9(j). Second, the proposed rule promulgates a revised bond form that potentially expands and muddles the surety's exposure. Limited availability of surety bonds and other forms of financial assurance would prevent PVOs from operating, which negatively impacts competition.

I. <u>The $15 million ceiling</u>

Under the existing regulations, a PVO must file evidence of financial responsibility in the amount of not less than 110 percent of the highest unearned passenger revenue at any one time within the past two fiscal years. 46 C.F.R. § 540.5. Acceptable forms of security include insurance, escrow or a guaranty from a Protection

and Indemnity Association. 46 C.F.R § 540.5 (a), (b) and (c). Section 540.6 of the current regulations also permits the filing of a surety bond as evidence of financial responsibility. A bond that covers all passenger operations also must be in the amount of 110 percent of the unearned passenger revenue. 46 C.F.R. § 540.6(b). Whatever the type of security provided, the current regulations establish a maximum required amount of $15 million. 46 C.F.R. § 540.9(j). The proposed rule states that the acceptable forms of security, including a surety bond, must be in the amount of 100 percent of the highest unearned passenger revenue (not including certain excepted credit card charges) at any one time during the past two years, plus 10 percent of the highest unearned revenue (including the excepted credit card charges). The proposed rule does not include any maximum amount.

We understand that unearned passenger revenues currently exceed $2 billion, which is attributable primarily to four companies. Therefore, the required bond amounts under the proposed rule would be in the hundreds of million of dollars. The availability of bonds in such increased amounts in today's market is highly uncertain. As bond amounts increase, a surety increases its underwriting criteria and requirements. At certain levels, very few, if any, companies qualify. Availability is further squeezed by current market conditions. The surety industry has experienced three years of losses. In response to those losses and in an effort to return to profitability, sureties have tightened their underwriting parameters. In addition, reinsurance capacity is restricted in the current market which in turn limits the amount of a credit a surety may extend on a single risk. Under the proposed rule, PVOs with unearned revenue greater than $15 million likely will encounter difficulty in seeking increased bond amounts in the current surety market. The inability to obtain increased security will negatively impact competition as some PVOs will be excluded from the market.

We note that on at least two prior occasions the FMC has considered removal of the financial assurance ceiling, only to determine ultimately that the ceiling should be retained. First, in 1990, related to a decision to increase the ceiling, FMC initiated a Fact Finding Investigation. The Report of that investigation concluded that if the ceiling were removed or increased, "costs would be raised and individual passenger's protection would not necessary be increased." Next, in 1994 and 1996, the FMC considered the issue under Docket No. 94-06. However, after consideration, the FMC did not take action. In each case SAA submitted comments which cautioned the FMC regarding the negative impact to bond availability that would be caused by the removal of the ceiling. We urge the FMC to exercise the same caution with respect to this proposed rule and consider the negative impact to bond availability caused by eliminating the ceiling.

II. <u>The changed nature of the bond obligation</u>

The existing bond form (Form FMC 132A) states that the bond shall inure to the benefit of passengers to whom the PVO is legally liable for damages. Such damages are those incurred "by reason of the Principal's failure faithfully to provide . . . services in accordance with the ticket contract made by the Principal and passenger . . . ." 46 C.F.R Part 540, Subpart A, Form FMC FMC-132A. The focus of the obligation is the PVO's performance in accordance with the ticket contract. The surety's obligation under the existing form is clearly identifiable: damages for which the PVO is legally liable arising out of the ticket contract.

The proposed rulemaking introduces a revised surety bond form FMC-132A, which states in part:

> . . . this bond . . . shall inure to the benefit of any and all passengers to whom the Principal may be held legally liable for any of the damages herein described in the event such legal liability has not been discharged by the Principal within 21 days after such passenger obtained a final judgment . . . or has obtained an arbitration award.

The proposed bond form expands the scope of the obligation to include payment of arbitration awards and performance of services not limited explicitly by the requirements of the ticket contract. In assessing its risk a surety attempts to identify the "boundaries" of the obligation. Under the existing form, the boundary can be identified easily as the requirements of the ticket contract. Using the contract as a reference point, all parties could determine whether nonperformance had occurred. Under the proposed form services are not explicitly limited to those required in the contract. Whether nonperformance has occurred is less clear, which creates uncertainty in the obligation, and thus higher risk.

The reference to arbitration in the proposed bond form creates greater uncertainty. It is not clear whether the surety would be required to pay an arbitration award that was not paid by the PVO, which has not been confirmed by a court. Judicial review is essential to determine the sufficiency of procedure and due process protections. Without such review, and with the surety not a party to the arbitration, the surety is exposed to a payment obligation for an award on which there are grounds to vacate or modify. If the bond is to cover arbitration awards, the form should require confirmation of the award by a court of competent jurisdiction before it is enforceable against the bond.

The increased required amount of security and the expanded exposure to the surety likely will impact adversely the availability of PVO surety bonds. We submit that the benefit of consumer protection expected with an increased bond amount may be offset by decreased competition due to the inability of some PVOs to obtain the increased security. Thank you for your consideration. Please contact me if you have any questions.

Sincerely,

Robert J. Duke